THE CITY OF SAN DIEGO

MEMORANDUM

DATE: November 29, 2010

TO: Members of the Budget and Finance Committee
Members of the City Council

FROM: Mark E. Leonard, Financial Management Director

SUBJECT: FY 2011 General Fund Year-End Revenue Projections

This memorandum presents updated projections for FY 2011 General Fund major revenues incorporating revenue receipts through November 2011. Based on results through the first four months of the fiscal year, year-end projections for these categories have been increased by $8.6 million over the Adopted FY 2011 Budget. These are very early results at this time of the fiscal year, and as such they are subject to future revisions as more actual information becomes available. Staff is cautiously optimistic regarding revenue trends although current economic indicators are still mixed. Some economists are predicting weak holiday sales compared to the prior year which may impact the final results for the fiscal year.

Table I shows the revised projections for major revenue categories and the variances from the FY 2011 Adopted Budget. Offsetting this positive variance is an anticipated negative variance in personnel expenditures in the amount of $2.0 million. During this past fiscal year, the City modified its approach to calculating the City's vacancy savings. It appears that the new methodology may have over-estimated vacancy savings in some departments. As with the revenue projections, staff will have a better estimate of this number as we move through the fiscal year.

TABLE I

General Fund Revenue ($ in millions)	Fiscal Year 2011 Adopted Budget	Fiscal Year 2011 Revised Projection	$ Variance	% Variance
Property Tax	$ 390.1	$ 384.7	$ (5.4)	-1.4%
Sales Tax	187.5	200.6	13.1	7.0%
Transient Occupancy Tax	66.1	67.6	1.5	2.2%
Franchise Fees	67.2	67.3	0.1	0.1%
Safety Sales Tax	6.3	6.4	0.1	1.4%
Property Transfer Tax	4.7	4.7	0.0	0.5%
Motor Vehicle License Fees	3.1	2.5	(0.7)	-21.9%
Subtotal	$ 724.9	$ 733.6	$ 8.6	1.2%
Personnel Expenditure Adjustment			$ (2.0)	
NET			$ 6.6	

ECONOMIC SUMMARY

Updated information from the California Employment Development Department, California State Controller's Office, USD Index of Economic Indicators, DataQuick Information Services, and U.S. Bureau of Labor Statistics was used in the preparation of the FY 2011 year-end revenue projections. The revised revenue projections for FY 2011 can be attributed to improving economic indicators, such as median home prices, local consumer confidence, and an increase in both local and statewide consumer spending which are somewhat offset by the lack of improvement in other economic indicators such as unemployment and countywide residential foreclosures.

Regional employment has been significantly impacted by declines in manufacturing and construction, in addition to other employment sectors. From January 2008 to September 2010, manufacturing and construction jobs in the region have declined 11.1 and 25.6 percent, respectively. Total individuals employed in the private sector declined to a post-recession low in January 2010. Any further increase or continuing high unemployment rate could negatively impact consumer spending which, in turn, will impact Transient Occupancy Tax (TOT) and sales tax projections.

In addition, tempering improvements in the local residential real estate market with increases in the median home price are the historically high levels of foreclosures in the County of San Diego. Although foreclosures are down 6.6 percent in the first nine months of calendar year 2010 from the same time period in 2009 and 31.7 percent down from 2008, this is still nearly double the number of foreclosures in 2007 prior to the recession. The latest information regarding the suspension of foreclosure proceedings by financial institutions such as Bank of America, JP Morgan Chase, and others, brings more uncertainty to the ability of the local market to reduce the supply of foreclosed properties.

MAJOR REVENUE PROJECTIONS

A discussion of all aforementioned major revenues listed in **Table I**, as well as the explanation of the variances from the FY 2011 Adopted Budget is presented below.

Property Tax

The updated property tax revenue projection is $384.7 million, which is $5.4 million, or 1.4 percent, below the FY 2011 Adopted Budget of $390.1 million. Since the release of the major revenues update in September 2010, the City received the updated property tax roll for FY 2011 from the County Auditor's Office which reflected a 1.47 percent decline in the City's assessed value (AV) as a result of a drop in the California Consumer Price Index (CCPI). This information was not available to the City at the time the FY 2011 Adopted Budget was prepared. The decline in AV negatively impacted the property tax revenue projection for FY 2011. However, this decline is offset by a projected increase in the property tax collection rate and forecasted reduction in reassessment appeals refunds. Both the increase in the property tax collection rate and the reduction in reassessment appeals refunds have been updated based on FY 2010 actual receipts. Taking into account this updated information, the property tax projection as of November 2010 has been reduced by $5.4 million from the FY 2011 Adopted Budget of $390.1 million.

Sales Tax

The updated sales tax revenue projection is $200.6 million, which is $13.1 million, or 7.0 percent, above the FY 2011 Adopted Budget of $187.5 million. The projection was updated based on the September 2010 actual receipts. The latest information received from MuniServices, LLC (the City's sales tax consultant) on individual retail sector performance (**Table II**), shows a growth in the general retail, transportation, and business to business categories and continuing declines in construction and miscellaneous sales. Gains in the general retail and transportation categories were mainly due to increases in service station sales and new automobile sales.

TABLE II

Economic Category (% of total)	2Q 2010 vs. 2Q 2009	2Q 2010 vs. 2Q 2008
General Retail (31%)	4.6%	-10.2%
Food Products (24%)	0.8%	-8.4%
Transportation (20%)	14.9%	-20.6%
Business to Business (17%)	2.3%	-21.3%
Construction (7%)	-5.0%	-24.6%
Miscellaneous (2%)	-13.3%	18.1%

Source: MuniServices, LLC

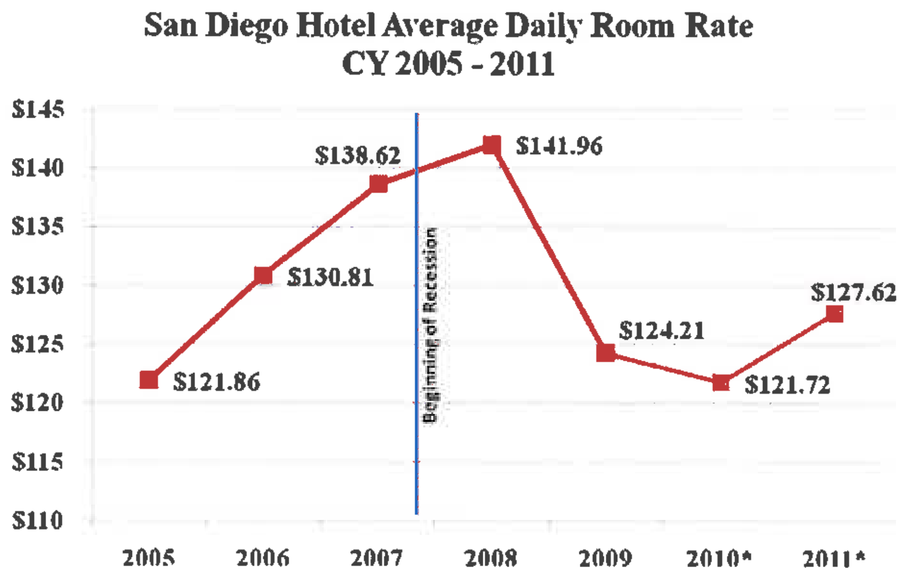
The previously forecasted growth rate in taxable sales of 0.0 percent for the remainder of FY 2011 has not been changed due to the mixed economic indicators discussed earlier (even though some have shown some improvement). Currently, the California Employment Development Department reports that San Diego's unemployment rate is at 10.6 percent and the State of California's unemployment rate is 12.4 percent. With unemployment rates for both San Diego and the State of California above the national unemployment rate of 9.2 percent, we are maintaining conservative projections in the sales tax growth rate for the remainder of this fiscal year. In addition, any drop in consumer spending will quickly impact the sales tax revenue received by the City. If economic indicators continue to improve, the growth rates for sales tax revenue may be revised in FY 2011.

Transient Occupancy Tax

The updated FY 2011 projection for the General Fund portion of Transient Occupancy Tax (TOT) is $67.6 million, which is $1.5 million, or 2.2 percent, above the FY 2011 Adopted Budget of $66.1 million. The updated citywide TOT year-end projection is $129.0 million compared to $126.2 million budgeted.

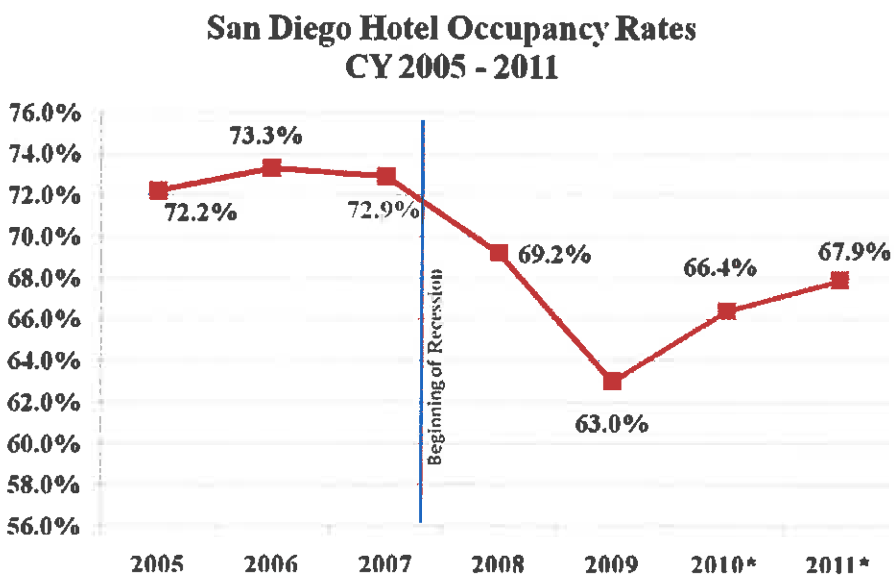
Recent growth in year-over-year TOT receipts for the months of June through September 2010 has been encouraging. Excluding May 2010, positive growth has occurred each month from March 2010 through September 2010. The San Diego Convention and Visitor Bureau (CONVIS) reports a strengthening in tourism for calendar years 2010 and 2011. Strong business travel continues to drive much of the growth in addition to better than forecasted overnight visits, as more tourists change visits to overnight stays from day trips incentivized by lower daily room rates. Growth projections from CONVIS in the average daily rate and room demand for calendar year 2010 and 2011 (**Graphs I, II**) also show stabilization and that moderate growth should be expected in this fiscal year. Although there are many indications that tourism to the San Diego region is on the upswing, the TOT projection remains conservative. This is based on the assumptions that there will be no growth in revenue (projected over the prior fiscal year's revenues) for the remainder of the current fiscal year as only one quarter of results is available and consumer spending may change based on mixed economic information.

GRAPH I



Source: San Diego Convention and Visitor Bureau

GRAPH II



Source: San Diego Convention and Visitor Bureau

Franchise Fees
The updated projection for Franchise Fees is $67.3 million, which is $70,000, or 0.1 percent, above the FY 2011 Adopted Budget of $67.2 million. The projection for Franchise Fee revenue has increased due to revised projections for revenues from the Sycamore Landfill. There are no other changes to projections for Franchise Fees at this point in the fiscal year.

Safety Sales Tax
The updated projection for Safety Sales Tax is $6.4 million, which is $81,000, or 1.3 percent, above the FY 2011 Adopted Budget of $6.3 million. The positive variance in the year-end projection is due to actual receipts in the first four months of FY 2011 which have marginally exceeded expectations. The distribution of safety sales tax revenues to cities is based on a different allocation formula than the distribution of sales tax. Therefore, this revenue does not necessarily mirror the growth in sales tax revenue.

Property Transfer Tax
The updated projection for property transfer tax is $4.7 million, which is equal to the FY 2011 Adopted Budget of $4.7 million. The updated year-end property transfer tax revenue projection for FY 2011 is based on revenue receipts through the first four months of FY 2011. Revenue through the first three months of the fiscal year was below budgeted amounts. However, property transfer tax revenue receipts in October 2011 were above budgeted amounts which may be attributable to the sale of the Vantage Pointe condominium development. The 769-unit project was sold for $200 million with estimated $110,000 in property transfer tax revenue to the City. Without the Vantage Pointe sale, the property transfer tax revenue projection would be $4.5 million, which would be a negative variance of $88,000, or 1.9 percent, below the FY 2011 Adopted Budget. Projections for the remaining periods of FY 2011 are based on conservative estimates due to mixed economic information and the expiration of the federal home buyer tax credit.

Motor Vehicle License Fees
The updated projection for Motor Vehicle License Fees (MVLF) is $2.5 million, which is $690,000, or 21.9 percent, below the FY 2011 Adopted Budget of $3.1 million. This projection is based on actual receipts through the first four months of FY 2011 and reflects uncertainty over the economic outlook of the auto sales industry as well as increasing Department of Motor Vehicle (DMV) administrative costs. Consumers are purchasing vehicles at levels above FY 2009 and 2010 levels; however, this is still well below levels experienced prior to the onset of the recession. Increasing DMV administrative costs (which DMV pays to itself first before allocating revenues to local jurisdictions) is a considerable contributor to the projected negative variance at year-end as such costs continue to consume a larger share of MVLF revenue than originally projected. Total MVLF receipts through the first four months of the fiscal year are below budget by 4.0 percent while DMV administrative costs have risen 7.0 percent above budget.

PERSONNEL EXPENDITURE ADJUSTMENT
A comprehensive review of General Fund expenditures will be completed and incorporated into the FY 2011 Mid-Year Budget Monitoring Report scheduled for release in February 2011. The results of the analysis are unknown at this time; however, there is one known personnel expenditure issue that should be mentioned in conjunction with this revenue update. Staff has become aware that the methodology used in calculating the vacancy savings may have over-

estimated the savings in some departments. In these cases, the personnel budget may need to be increased to meet budgeted staffing requirements. At this time, we are aware that adjustments may need to be made in the Library and Park and Recreation Departments. The current estimate of this adjustment is \$2.0 million. Staff will fully evaluate the magnitude of this issue across all General Fund departments as part of the FY 2011 Mid-Year Budget Monitoring Report.

CONCLUSION

This memorandum presents updated projections for the FY 2011 General Fund major revenues through November 2010. Based on the actual receipts for the first four months of the fiscal year, year-end projections for these major revenues have been increased by \$8.6 million. These are preliminary results at this time of the fiscal year, and as such they are subject to future revisions as more actual information becomes available during the remainder of the fiscal year.

Other General Fund revenues (such as departmental revenues) have not been evaluated at this time. All General Fund revenue sources will continue to be analyzed and updated, and will be included in the FY 2012-2016 Five-Year Financial Outlook and FY 2011 Mid-Year Budget Monitoring Report.

Finally, staff is aware of an expenditure issue that may result in mid-year budget adjustments requiring the use of additional revenues to fund. The current estimate of the amount of the adjustment is \$2.0 million.

Mark E. Leonard
Financial Management Director

cc: Honorable Mayor Jerry Sanders
Jay M. Goldstone, Chief Operating Officer
Mary Lewis, Chief Financial Officer
Andrea Tevlin, Independent Budget Analyst